



# Reading Financial Statements

## Course Instructor – Scott



**Scott Powell**

Chief Content Officer

### About Scott...

Scott is a CFI founder and the company's Chief Content Officer. Now based in Vancouver, Scott spent a significant portion of his career in London, New York, and Hong Kong. Scott has a passion for teaching with over 25 years of experience designing and delivering learning solutions for firms in the financial services sector – particularly in the areas of commercial banking, investment banking, capital markets, and asset management. Some of the companies he has worked with over his career include Bank of America Merrill Lynch, BCI, Credit Suisse, Deutsche Bank, HSBC, ING, JP Morgan, Royal Bank of Scotland, and TD Bank, to name but a few.

# Learning Objectives



Outline the contents of an annual report.



Explain a company's operations and business strategy.



Identify the many risk factors a company must navigate.



Analyze company financial statements, as well as its different business segments.



Read and comprehend the Management Discussion & Analysis (MD&A) section.



Review the notes to the financial statements for additional detail.

# Understanding the Annual Report

# The Benefits of an Annual Report

Publicly traded companies and many other organizations publish an annual report after the end of their fiscal year.



## Financial

- Management discussion & analysis (MD&A)
- Financial statements
- Notes to financial statements



## Operational

- Messages from the Chair, CEO
- Corporate profile
- MD&A
- Risk and control processes and analysis



## Strategic

- Growth and investment plans
- Cost-cutting initiatives
- Human capital strategy
- Acquisitions outlook

# Contents of an Annual Report

01.

Letter to the  
shareholders

02.

Business  
description

03.

Management's  
Discussion and  
Analysis (MD&A)

04.

Reporting on  
internal controls

05.

Audit report

06.

Balance sheet,  
Income  
Statement, and  
Statement of  
Cash Flows

07.

Notes to the  
financial  
statements

08.

Earnings per share

09.

Listing of  
directors of the  
company

# Understanding Financial Statements

# The Three Main Financial Statements



## Income Statement

Statement of operation /  
profit and loss

Revenues

Expenses

Profit or loss



## Balance Sheet

Statement of financial  
position

Assets

Liabilities

Equity



## Cashflow Statement

Statement of cash  
flows

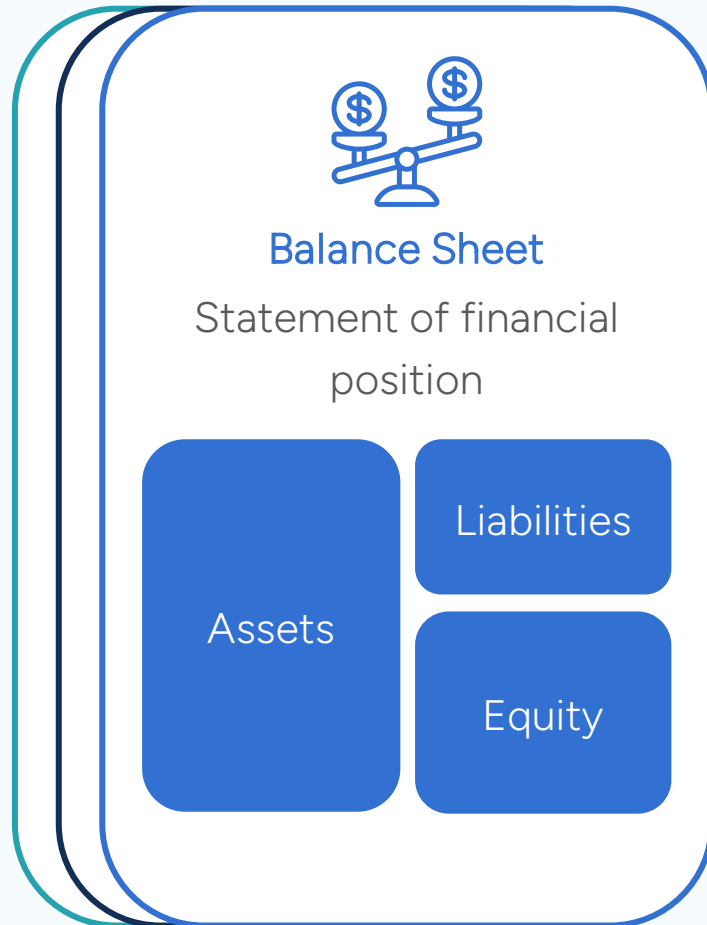
Operating

Investing

Financing



# Balance Sheet

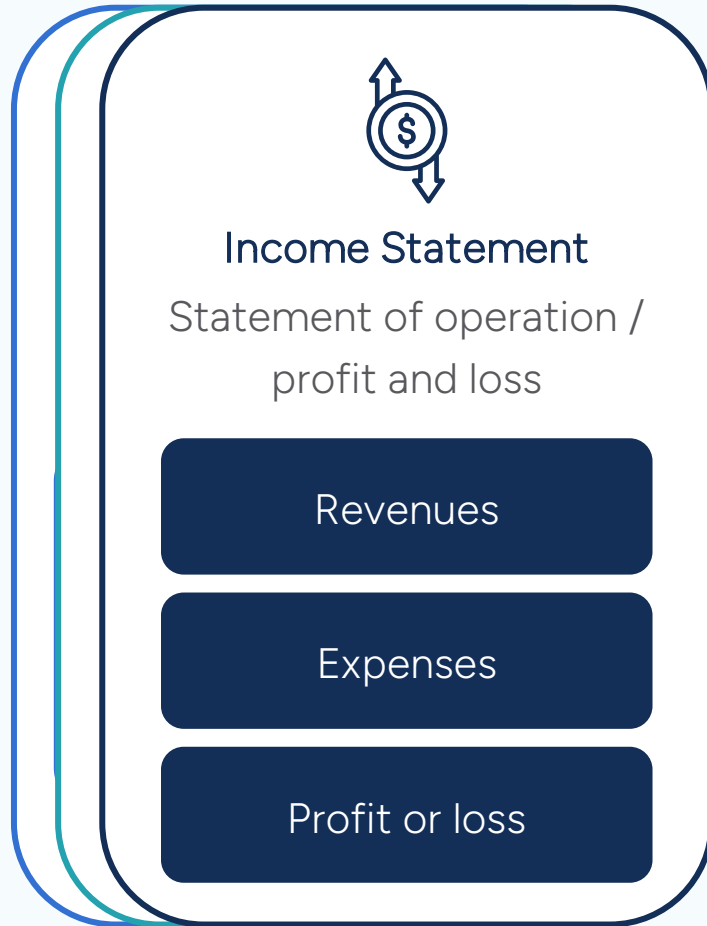


Represents a snapshot of the **financial position** of the company at a point in time.



Important component of determining the **financial strength** of a company.

# Balance Sheet



Income Statement  
Statement of operation /  
profit and loss

Revenues

Expenses

Profit or loss

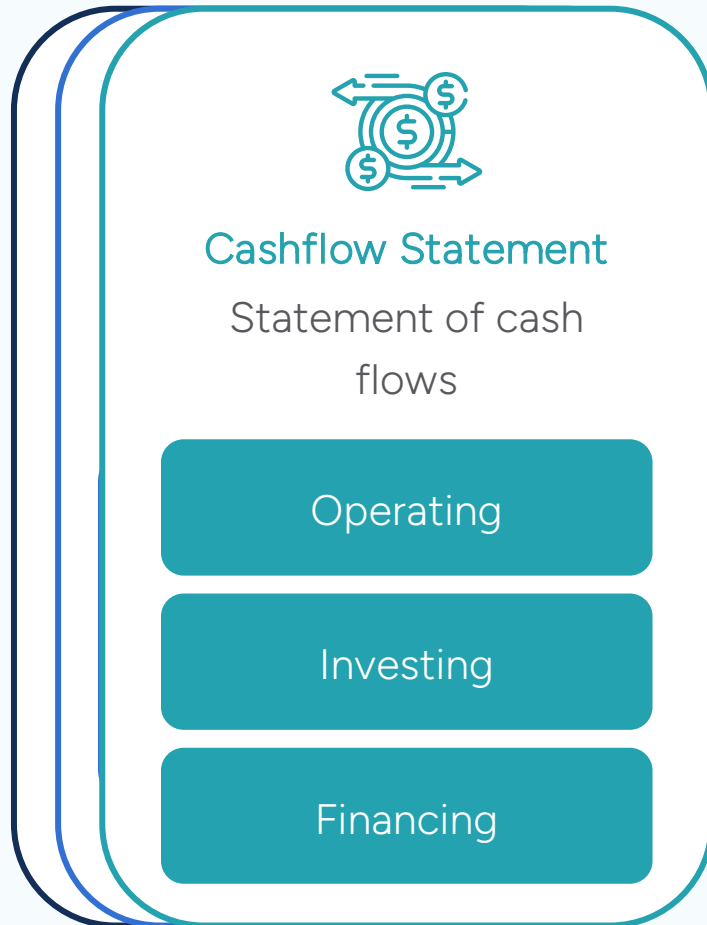


Contains the transactions of a  
company **over a period of  
time** (quarterly or annual).



Uses **accrual accounting  
rules** to show all revenues and  
expenses.

# Balance Sheet



Categorizes cash flows by  
**operating, investing, or  
financing activities.**



Closing cash balance will  
**match the balance** on the  
balance sheet.

# Simplified Balance Sheet

	Assets		Liabilities		
●-----	Current assets		Current Liabilities		-----●
Expected to	Cash	20,000	Accounts payable	2,000	Expected to be
convert into	Accounts receivable	3,000	Accrued expenses	1,000	paid in <1 year
cash <1 year	Inventory	60,000	Total current liabilities	3,000	
	Prepaid expenses	11,000	Non-current liabilities		-----●
	Total current assets	94,000	Bank loan	111,000	Expected to be
					paid in > 1 year
●-----	Non-current assets		Shareholders' Equity		
Expected to be	Property Plant & Equipment	110,000	Common shares	89,000	
held > 1 year	Intangible assets	10,000	Retained earnings	11,000	
	Total non-current assets	120,000	Total common equity	100,000	
	Total assets	214,000	Total liabilities & Equity	214,000	

# Investments



A company will **hold external investments** for two reasons:

- ✓ Excess cash
- ✓ Accumulating cash to make a large purchase



Companies may also make **internal investments**.



Joint venture



Subsidiary

**Short Term**  
(less than year)

or

**Long Term**  
(more than year)

# Investments

## STARBUCKS CORPORATION CONSOLIDATED BALANCE SHEETS

(in millions, except per share data)

	Oct 1, 2023	Oct 2, 2022
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 3,551.5	\$ 2,818.4
Short-term investments	401.5	364.5
Accounts receivable, net	1,184.1	1,175.5
Inventories	1,806.4	2,176.6
Prepaid expenses and other current assets	359.9	483.7
Total current assets	7,303.4	7,018.7
Long-term investments	247.4	279.1
Equity investments	439.9	311.2
Property, plant and equipment, net	7,387.1	6,560.5
Operating lease, right-of-use asset	8,412.6	8,015.6
Deferred income taxes, net	1,769.8	1,799.7
Other long-term assets	546.5	554.2
Other intangible assets	120.5	155.9
Goodwill	3,218.3	3,283.5
<b>TOTAL ASSETS</b>	<b>\$ 29,445.5</b>	<b>\$ 27,978.4</b>

# Investments

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# Deferred Taxes

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# Deferred Taxes

Tax Rules



Taxable  
Income

Accounting Rules



Accountable  
Income



If the deduction will be allowed in the future, there will be a timing difference, and a deferred tax will be recorded.

## Example:

Accounting income

+ Accounting depreciation (straight-line method)

- Tax depreciation (declining method)

---

Taxable income



The difference is the basis for deferred income taxes (future income taxes) and is recorded on the balance sheet.

# Goodwill

If a company is **purchased for more** than the fair value of **net assets** (assets less liabilities):

Purchase price	x
Fair value of net assets acquired	(x)
<hr/>	
Goodwill	x

## Goodwill:

i.e., brand, customers, intellectual capital



- ✓ Intangible value
- ✓ Non-current assets
- ✓ Measured annually

# Intangible Assets

Intangible assets are assets that are used to **generate revenue** but have **no physical substance**.



## Trademarks

(i.e., Coca Cola trademark, Nike swoosh).



## Patents



## Copyrights

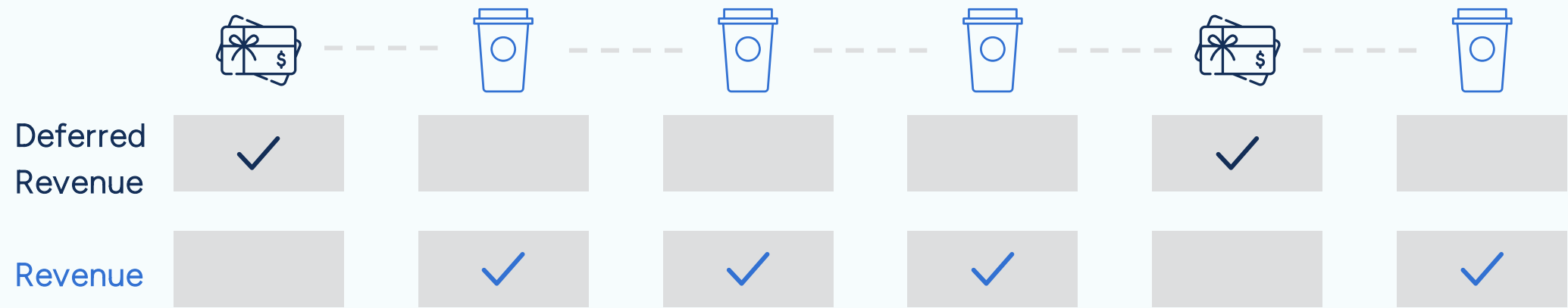
### Intangible Assets:

- ✓ Appear on the balance sheet
- ✓ Amortized, like PP&E

# Deferred Revenue

Deferred revenue, also known as unearned revenue, arises when a company **sells something it has not yet delivered**.

Long-term debt	13,547.6	13,119.9
Operating lease liability	7,924.8	7,515.2
Deferred revenue	6,101.8	6,279.7
Other long-term liabilities	513.8	610.5
Total liabilities	37,433.3	36,677.1



# Common vs. Preferred Shares

## Common Shares:



Allows for participation in the profits of the company.

- Comes in the form of dividends



Allows for voting rights in a company.

- One vote for every share held



If dissolved, any residual amount after everyone else has been paid goes to common shareholders.

## Preferred Shares:



Offers investors a fixed dividend.

- It may or may not only be paid annually



Will accumulate/pay before common share dividends.



Usually carries no voting rights in a company.

# Authorized Shares vs. Outstanding Shares



## Authorized Shares

---

The total number  
of **shares a**  
company can sell.



## Outstanding Shares

---

The total number  
of **shares a**  
company has sold.

# Contributed Surplus

Another item that may appear in the equity section of a company's balance sheet is **contributed surplus or paid-in capital**.



## Example:

180,000 Shares  
40¢/each  
25¢/par



How would this be **shown** on their **balance sheet**?

Paid-up share capital (180,000 x 25¢)	\$45,000
Contributed surplus (180,000 x 15¢)	\$27,000



# Par Value & Contributed Surplus

Starbucks has shares with a par value of 1/10<sup>th</sup> of a cent.

Shareholders' deficit:		
Common stock (\$0.001 par value) — authorized, 2,400.0 shares; issued and outstanding, 1,142.6 and 1,147.9 shares, respectively	1.1	1.1
Additional paid-in capital	38.1	205.3
Retained deficit	(7,255.8)	(8,449.8)
Accumulated other comprehensive income/(loss)	(778.2)	(463.2)
Total shareholders' deficit	(7,994.8)	(8,706.6)
Noncontrolling interests	7.0	7.9
Total deficit	(7,987.8)	(8,698.7)
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY/(DEFICIT)	\$ 29,445.5	\$ 27,978.4

## Authorized vs Outstanding



2.4000 billion shares authorized

1.1426 billion shares outstanding

# Accumulated Other Comprehensive Income

AOCI represents certain gains and losses a company may have that are **not recorded through the income statement**.

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## AOCI Example:



Unrealized gains and losses on hedging instruments.

# Noncontrolling Interests

Some companies will recognize noncontrolling interest on the balance sheet, with a corresponding expense on the income statement.

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Check our [Accounting for Business Combinations & Other Equity Investments](#) course for more on noncontrolling interest.

# The Full Disclosure Principle

A critical part of reading a set of financial statements relates to the **notes** that accompany them.

Explains how inventory is recorded.

Describes what is included in deferred taxes.

STARBUCKS CORPORATION		
INDEX FOR NOTES TO CONSOLIDATED FINANCIAL STATEMENTS		
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Notes allow the reader to make **more informed judgments** on the financial activities of the company.

# Significant Accounting Policies

One of the most important financial statement notes is the **significant accounting policies note**.



Company  
accounting  
standards



How inventory &  
investments are  
valued



Financial  
instruments



How revenue is  
recognized



How PP&E is  
amortized



Any other  
policies

# Income Statement & Cashflow Statement

# Introduction to the Income Statement



## Income Statement

Statement of operation /  
profit and loss

Revenues

Expenses

Profit or loss

## The Income Statement



Contains transactions of a company over a period of time.



Starts with a zero balance and contains transactions affecting revenues and expenses.



Summarizes revenue, expenses, and net profit after amortization, interest, and taxes.



The importance of the income statement is in showing the profitability of the company.

# Cost of Sales

Cost of goods sold may also be referred to as cost of sales, which is the description normally given in a service-based industry.



## Direct Materials

(I.e., materials used in manufacturing)



## Direct Labor

(I.e., professional services delivered)



## Other Allocations

(I.e., overhead, costs related to production)



# Selling, General and Administrative Expenses

SG&A contains a **large number of expense items** that are all **grouped into one line item** on the income statement.



Advertising and  
promotion  
costs



Legal, insurance,  
and accounting  
expenses



Office  
supplies



Rent



Other related  
expenses

# Gains and Losses

Gains and losses may be shown separately or may be grouped under **other income and expenses**.

They are related to activities that are **incidental to the operations** of the business, such as:



Sale of investments



Financial instrument transactions



Check our [Accounting for Business Combinations & Other Equity Investments](#) course for more on equity investees and income from associates.

# Introduction to the Cashflow Statement



## Cashflow Statement

Statement of cash  
flows

Operating

Investing

Financing

## The Cashflow Statement:



Organizes all transactions that affect cash to arrive at the net cash movement for the year.



The closing cash balance will match the cash reflected on the balance sheet.

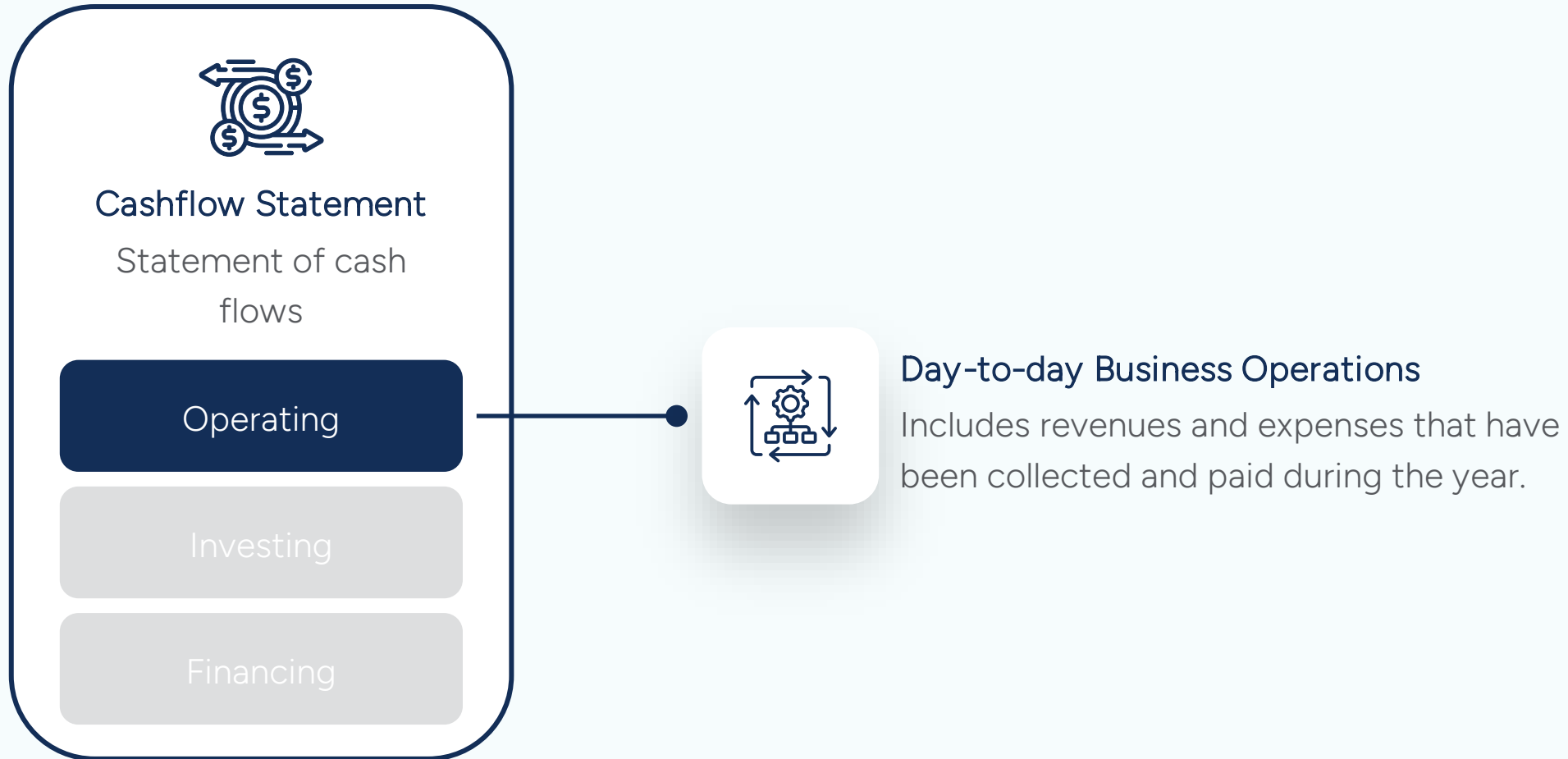


Shows where cash is being generated and where it's being used in the business.

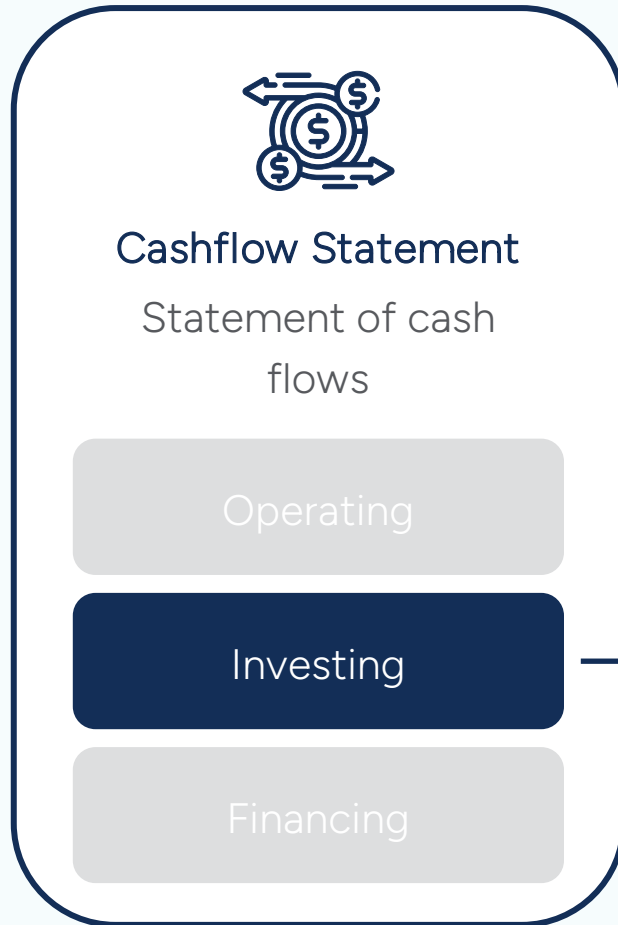


Transactions are sorted by operating activities, investing activities, and financing activities.

# Operating Activities



# Investing Activities



**Non-current assets that support the business**  
Includes property, plant & equipment, as well as business acquisitions.

# Financing Activities



## Cashflow Statement

Statement of cash  
flows

Operating

Investing

Financing



## Transactions regarding shares or debt

A company raises funds by either borrowing or issuing shares.

# Direct vs Indirect Method

Direct Method	Indirect Method
<b>Operating Activities</b>	<b>Operating Activities</b>
Cash collected from customers	Net income
Cash paid to suppliers	Add back depreciation & amortization
Cash paid to employees	Adjust change in working capital balances
Cash flow from operating activities	Cash flow from operating activities
<b>Investing Activities</b>	<b>Investing Activities</b>
Purchase of equipment	Purchase of equipment
Disposal of property	Disposal of property
Cash flow from investing activities	Cash flow from investing activities
<b>Financing Activities</b>	<b>Financing Activities</b>
Issuance of shares	Issuance of shares
Repayment of debt	Repayment of debt
Cash flow from financing activities	Cash flow from financing activities
<b>Net movement in cash</b>	<b>Net movement in cash</b>

# Course Summary